



Tucows Q3 2022 Management Remarks Transcript

Introduction [Monica Webb, Senior Director, Investor Relations]

Welcome to Tucows' third quarter 2022 management commentary. We have prerecorded prepared remarks regarding the quarter and outlook for the Company. A Tucows-generated transcript of these remarks, with relevant links, is also available on the Company's website.

In lieu of a live question-and-answer period following these remarks, shareholders, analysts and prospective investors are invited to submit questions to Tucows management via email at ir@tucows.com until November 10th. Management will address your questions directly or in a recorded audio response and transcript that will be posted to the Tucows website on November 22nd at approximately 4 p.m. Eastern time.

We would also like to advise that the updated Tucows Quarterly KPI Summary, which provides key metrics for all of our businesses for the last seven quarters, as well as for full years 2020 and 2021, and also includes historical financial results, is available in the [Investors section of the website](#) along with the updated [Ting Build Scorecard and Investor Presentation](#).

Now for management's prepared remarks:

On Thursday, November 3rd, Tucows issued a news release reporting its financial results for the third quarter ended September 30th, 2022. That news release, and the Company's financial statements, are available on the Company's website at tucows.com under the Investors section.

Please note that the following discussion may include forward-looking statements, which, as such, are subject to risks and uncertainties that could cause actual results to differ materially. These risk factors are described in detail in the [Company's documents filed with the SEC](#), specifically the most recent reports on the Forms 10-K and 10-Q. The Company urges you to read its security filings for a full description of the risk factors applicable for its business.

Finally, as discussed previously, starting in Q1 of this year, we started reporting as separate businesses—Ting, Wavelo and Tucows Domains—in addition to Tucows Corporate. For those that have yet not done so, I encourage you to watch the [video](#) we posted on the Tucows Investors site in February for additional detail and perspective on the rationale for this change.

I would now like to turn the call over to Tucows President and Chief Executive Officer Elliot Noss. Go ahead, Elliot.

Management Remarks [Elliot Noss, President and Chief Executive Officer]

Introduction

Thanks, Monica.

Q3 was another solid quarter in a tough operating environment. The world is full of uncertainty, and in times like these, it is important to focus on what you can control. We continue to be grateful that focusing on cash generation is useful, if undervalued, in good times, but extremely important in times of uncertainty.

Q3 was our third quarter managing the businesses under the new corporate structure. As we wrap up our 2023 budget cycle, we have learned important lessons and will be able to refine TCX operations in order to better serve the operating businesses. The change in structure is a success, allowing us important financial flexibility without losing—in fact, in some ways gaining—operational efficiency.

In addition, I would like to reiterate our previously provided guidance. To the above point, we have now provided four points of guidance rather than just one and are pleased that this has not proven unduly difficult.

A reminder that as part of changing our reporting by business segments, you will now hear directly from the heads of each business in these remarks, as well as from our CFO, Dave Singh, who will cover our financial results in detail.

The first speaker is Dave Woroch, Chief Executive Officer, Tucows Domains. Go ahead, Dave.

Tucows Domains [Dave Woroch, Chief Executive Officer, Tucows Domains]

Thanks, Elliot.

Tucows Domains had a relatively flat quarter year over year, as both the domain industry and our business continue to return to prepandemic levels. The boom of COVID has given way to an echo but with a continued positive trend when looking over longer time frames.

Revenue for Domain Services for the third quarter was down 1% from the same quarter of last year, and gross margin was down 2%. Domain Services' adjusted EBITDA was down 9% from Q3 of last year. Here I will note that the decrease in adjusted EBITDA is a result of both the lower gross margin as well as increased operating expenses. And in line with how we have

always endeavored to manage this business efficiently, and especially now as we approach the anniversary of the new corporate structure, and in an inflationary environment, we are reviewing and streamlining expenses.

Building off my comments in the second quarter, total transactions for the business have continued at the lower, prepandemic levels that we have discussed in previous quarters. As with many in our industry, we too see the broad-based economic and other challenges and the uncertainty of the global economy. Connected to this, the rapid appreciation from earlier this year in the value of the U.S. dollar has impacted our European business and introduced challenges. For many of our resellers in Europe, we price services in euros and have a cost base in U.S. dollars. The currency impacts from the U.S. dollar gaining strength against the euro has and continues to apply downward pressure to our gross margin. To address this, we have adjusted prices in Q3 and have announced that we will do so again later this quarter.

Returning to the two segments of our business, in our Wholesale channel, revenue for Q3 was essentially unchanged year over year, with gross margin down 2%. Within the Wholesale channel, Domain Services' revenue was likewise unchanged from the same period last year, while gross margin was down 4%. Revenue for the Value-Added Services component of the Wholesale channel was unchanged year over year, with gross margin up 2%. Worth noting: the gross margin from Wholesale Domain Services is up 8% when compared to Q3 of 2019 and pre-COVID.

In our Retail channel, revenue decreased 4%, while gross margin decreased 1% year over year.

And lastly, our combined overall renewal rate, at 80% in Q3 across all Tucows Domains brands, remains well above the industry average.

Since we founded the Tucows Domains business early in 2000, we've weathered different global and regional economic cycles and conditions by focusing on managing our business responsibly and with a long-term view. We provide access to domain and related services that have become integral to how consumers and businesses use the internet for life and work today. We've defined innovation with continual evolution of our domain platform. And we've built a strong global distribution channel for our domain services. Today, in light of the last few years, I'm grateful we can stand on the foundation of such a resilient, consistent business and that we have the people and resources to always be thinking about how we leverage what we do best to create growth opportunities for our business and our customers. And I'm excited to tell you more about that—beyond my comments in Q2—as it develops.

Now over to Justin Reilly, CEO of Wavelo.

Wavelo [Justin Reilly, Chief Executive Officer, Wavelo]

Thanks, Dave, and hello TCX investors.

I want to frame my comments today by reemphasizing some of my remarks from last quarter. We have now started the migration of Boost customers in earnest. As that process reaches scale, we expect to reach an inflection point in the business sometime around Q2 next year, where we are transitioning from one-off professional services revenues from DISH to ramping up a scalable, high-margin, recurring revenue model based on subscribers from DISH and Ting.

We're extremely excited about the growth trajectory of the business with our current customers and potential new ones.

Now the financial report. Year over year, revenues and gross profit are up modestly: 5.3% and 2.9%, respectively. Quarter over quarter is where we see the numbers look lumpy, as expected, with revenue for Q3 at \$4 million, a decline of 55% from Q2, and gross margin at \$3.8 million—a decline of 52%. Revenue is down sequentially for two reasons: As we noted last quarter, we had an outsized revenue recognition in Q2 related to bundled professional services included as part of the platform services provided to DISH. This recognition occurs as an accounting treatment of some of the noncash terms in the DISH transaction. This lumpy revenue recognition was seen in Q1 as well. The second sequential revenue impact is from the partial reversal of a contract asset related to the noncash revenue recognition of certain fixed payment components. The contract asset and associated revenue recognition varies based on the estimated relative mix of variable and fixed payments. And note that the contract asset will unwind over the term of the contract, which is up for renewal in Q3 2024.

On the subscriber fee component of revenues, both Wavelo and DISH had hoped to have more Boost subscribers migrated at this point. As we noted above, the migration process is now underway. We are pleased that DISH has been putting new Boost customers on the platform for a while. As always, we recommend you review DISH's disclosures, including the mention in their Q2 remarks of the significance of the CDMA shut down to their focus and progress.

As a reminder from last time, the two most challenging parts of any new customer engagement are network integrations and customer migrations. We've completed three network integrations—T-Mobile, ATT, and DISH 5G—in record time, highlighting the agility of Wavelo's platform. This gives DISH an unparalleled advantage as they compete both in retail wireless and as the 4th MNO. In addition to network integrations, we've built world-class migration tools to help DISH migrate Boost subscribers. As with any hard endeavor, these are iterative

exercises, and we've recently completed finishing touches to help DISH migrate subscribers more seamlessly. These will be important tools for future Wavelo customers. We're seeing positive signs from DISH's announced plans around financing and build-out that bode well over the next three quarters. DISH has announced its intentions to introduce Boost Infinite, a postpaid offering with disruptive unlimited usage pricing, expected over the next few quarters. Postpaid products are typically much stickier than prepaid, which the current Boost base is. Additionally, DISH is on track to meet their June 2023 deadlines for their 5G deployment, with 70% of the U.S. population coverage and 15,000 cell sites. We believe strongly in the compelling proposition from DISH of an extensive, high-quality cell coverage, and flexible pricing and packages, to attract and retain mobile customers, which in turn benefits Wavelo. There may be no more compelling case for Wavelo's platform than DISH's ability to launch prepaid and postpaid offerings inside of the same billing and provisioning system. This means launching new plans in hours, not months, regardless of when you'd like to bill the customer and regardless of which network provides the service. For those keeping score over the last 25 years of telecom, this has plagued operators as they attempt to adapt to an evolving market of competitors and consumers. We're confident that Wavelo's flexibility will be a key enabler in helping DISH win in the coming years.

Our adjusted EBITDA number for Q3 was negative \$0.9 million, which reflects the burn at this point in the growth of the business as we staff up where needed to continue critical development work and round out our core leadership and support teams. And with respect to our burn, one reason the migration of Boost subscribers is important is that once the majority of Boost customers are transitioned to the platform, those fees will fund most of our opex, and accordingly, we'll be investing in more sales and marketing. And for the rest of this year, we're continuing to focus on developing and launching new key features for our two anchor customers, DISH and Ting, and building *our* go-to-market machine.

Thanks for listening, and now over to Elliot.

Ting [Elliot Noss, President and Chief Executive Officer, Tucows]

Thanks, Justin.

In Q3, Ting delivered another strong quarter of fiber construction, deploying close to the same record fiber footage as we did in Q2. The serviceable address number is dampened fairly significantly this quarter as we resolved a small issue in California that was administrative in nature that will push roughly seven thousand addresses into Q1 of 2023.

Our Q3 fiber capex was again near \$25 million at \$23.7 million. This is up over 70% year over year as we continue accelerating our build.

We added 2,300 net subscribers in Q3, taking us to 32,600 in total. That represents growth of nearly 8% from last quarter and 42.5% year over year. Our total for both Ting-owned and Ting Partner serviceable address additions was 4,800, taking us to 108,500 total serviceable addresses. We expect those numbers to ramp in Q4 and into 2023 as some of the backlog referred to above comes online.

We continue to have a strong pipeline of orders to installs as addresses become serviceable—including in our mature markets—despite increased competition and economic uncertainty. This reinforces our belief that people see internet service as essential, and they view Ting to be superior to other options. In this regard, I note that our qualitative feedback from customers and our customer engagement scores continue to reinforce our belief that Ting customers truly are the most satisfied ISP customers in the United States.

Starting in Q1, on page 2 of the KPI Summary, we provided new disclosure on mature vs. growth markets. You may recall I said these metrics would provide a view of how more mature markets grow as they load customers and generate powerful net margins. I also noted in Q2 that these numbers were a little uneven on the bottom line as we still had plenty of new construction happening in North Carolina and Colorado—our two largest footprints. That being said, Q3 was strong. The mature market contribution for Q3 is \$2.3 million, up 45% from Q2 and 25% year over year. More importantly, gross profit grew by 15% quarter over quarter, and 141% year over year, to \$6.7 million. Ting's revenue grew 7% quarter over quarter, and 71% year over year, to \$11 million. This will continue to tell a clean story on the top line and to be a little more uneven on the bottom line as we continue to build in larger, mature footprints.

We continue to work on how to best let investors see operating leverage. We are using the 2023 budget process as a forcing mechanism and expect to have more on this next quarter.

For market updates, microtrenching continues in our markets in Culver City, California, and Centennial, Colorado, as well as our partner markets in California. We also started microtrenching in Alexandria, Virginia, in Q3, and that work will accelerate in Q4 with our first customers expected there in early 2023. We've also completed a lot of fiber footage in our North Carolina footprint, primarily connecting new greenfield areas. We're also excited for Colorado Springs to start their construction in Q4 of this year and look forward to Aurora, Colorado, getting underway in 2023.

I'm also pleased to report on our work related to the Ting Internet financing we announced last quarter with Generate Capital. We're actively engaged on strategic and operational fronts with their teams preparing for a busy 2023. Generate's subsidiary Ubiquity has taken over

managing our partner markets in Solana Beach and Encinitas, and we're seeing new momentum in completing the Encinitas build, creating a nice foothold in San Diego County.

As we round the turn and head for home in 2022, it is worth noting that interest rates, labor costs and, most importantly, the increased expectation of fiber overbuilding have started to chip away at the incredible returns that the coax-to-fiber transition offers. The good news is that our focus on above-market take rates and profitability and, most importantly, our flexibility in providing ISP services on both our own as well as others' networks, has us in a relatively strong position. Focusing on execution plays to our strengths.

And now I'd like to turn the call over to Dave Singh for a deeper dive on our financial results.

Financial Results [Dave Singh, Chief Financial Officer]

Thanks Elliot...

Total revenue for the third quarter of 2022 increased 2.8% to \$78.1 million from \$75.9 million for the third quarter of 2021. The increase was primarily from Ting and Wavelo – up 71% and 5.3% year over year respectively. Their gains were partially offset by a 44% decline in Tucows Corporate revenue, to \$2.8 million from \$4.9 million in Q3 of last year, driven by the expected decrease in transitional services revenue with DISH. Year-to-date total revenue for 2022 is \$242 million, up 9% from the year-to-date total revenue of \$222 million at the end of Q3 last year.

Revenue from Tucows Domains was essentially flat, at \$60.3 million down slightly from \$60.7 million in Q3 last year.

Cost of revenues before network costs for Q3 was down slightly at \$48.3 million, as compared to \$49.5 million for the same period of last year. As a percentage of revenue, cost of revenues before network costs decreased to 62% from 65% in Q3 2021. This was primarily due to growth in the high margin Ting Internet services revenues.

Gross profit before network costs for the third quarter increased 13% year over year to \$29.7 million, from \$26.4 million, with the increase due mainly to the higher gross profit contribution of Ting Internet. As a percentage of revenue, gross margin before network costs increased to 38% from 35%.

Breaking down gross profit by business, Tucows Domains' gross profit for the third quarter of 2022 decreased 1.7% from Q3 last year to \$18.2 million from \$18.5 million. As a percentage of revenue, gross margin for Tucows Domains was flat at 30% year over year.

Wavelo gross profit increased 2.9% to \$3.8 million from \$3.7 million for Q3 2021. As a percentage of revenue, gross margin for Wavelo was 94% compared with 96% in Q3 last year. As referenced earlier by Justin, Wavelo gross profit is down sequentially from Q1 and Q2 2022, driven by the non-cash amortization of the contract asset related to DISH.

Ting gross profit for Q3 increased 141% year over year to \$6.7 million, from \$2.8 million for the same period of last year. As Elliot discussed in the [Q2 management remarks](#), the growing contribution from Ting's mature markets is generating strong net margins.

As a percentage of revenue, gross margin for Ting expanded to 61% in the third quarter from 43% in Q3 last year driven by a stronger contribution from our growth markets, as well higher capitalization of our field and engineering labour.

Network expenses for Q3 increased 41% to \$11.8 million from \$8.3 million for the same period of last year. The increase continues to be driven by both the higher depreciation of our fiber network assets, up 54% year over year, as well as the increase in our workforce to support the expanding fiber network.

Total operating expenses for the third quarter of 2022 increased 29% to \$27.4 million from \$21.2 million for the same period last year. The increase is primarily the result of the following:

- People costs were up \$3.2 million this quarter, with increased workforce costs to support business expansion, related to Ting Internet growth, as well the continued Wavelo ramp, and to a lesser extent the acquisitions of Simply Bits as well as the UNR assets and its development team, both in October 2021.
- Sales and Marketing costs increased by \$1.2 million year over year, mainly driven by increased investments in the Ting Internet business expansion.
- Facility and third-party contracting and support costs were up \$0.5 million -- primarily related to Simply Bits, and credit card fees were up \$0.2 million while stock-based compensation increased \$0.5 million.
- And lastly, foreign exchange impacts increased expenses by \$0.4 million this quarter, primarily driven by the year-over-year impacts from the revaluation of our of foreign-denominated monetary assets and liabilities.

As a percentage of revenue, operating expenses increased to 35% for Q3 of this year from 28% for the same period last year.

We reported a net loss for the third quarter of 2022 of \$8.0 million, or \$0.74 per share, compared with net income of \$1.4 million, or \$0.13 per share, for the same period of last year. The net loss was driven predominantly by higher interest expenses, including the new

preferred debt with Generate Capital, the accelerated build of our fiber network and ongoing ramp of the Ting Internet operations, and related higher operational and depreciation expenses. Note, our tax expense reflects our geographic mix, with taxes payable in Canada on our legacy domains business.

Adjusted EBITDA for Q3 was \$7.9 million, down 35% from \$12.2 million for Q3 2021. That total breaks down amongst our three businesses as follows:

- Adjusted EBITDA for Tucows Domains was \$10.4 million, down 9.5% from Q3 of last year.
- Adjusted EBITDA for Wavelo was negative \$0.9 million, a decrease of 151% from a positive \$1.8 million last year. Wavelo results reflect the ongoing investment in ramping the business, as well as the non-cash impact of the amortization of the contract asset related to Dish. We expect the asset to amortize over the remaining term of the contract.
- Adjusted EBITDA for Ting was negative \$5.0 million compared with negative \$5.5 million in Q3 2021, an Adjusted EBITDA level we expect to continue as we fund our fiber network expansion.
- And finally, the Corporate category had adjusted EBITDA of \$3.4 million this quarter compared with \$4.5 million in Q3 last year, with the decline primarily driven by, and as expected, the lower earn-out from the sale of the Ting Mobile customers to DISH (as customers continue to churn), lower transition services margins, and lower contribution from the mobile subscribers retained offset slightly by a one-time recovery from the renegotiation of a supplier contract.

Turning to our balance sheet, cash and cash equivalents at the end of Q3 were \$30.5 million, compared with \$6.5 million at the end of the second quarter of 2022 and \$5.5 million at the end of the third quarter of 2021. This is due to the addition of cash from our funding facility with Generate, for use in the Ting business.

During the quarter, we had negative \$1.0 million in cash from operations compared with positive \$1.5 million in Q3 last year, with the decrease being due to our net loss this quarter, along with increases in deferred income taxes, accounts receivable, and inventory.

Our cash was more than offset by our investment of \$47 million in property and equipment, primarily for the accelerated build-out of the Ting Fiber Internet network, as well as the continued build of the Wavelo platform. Note, this number reflects the actual cash paid for capital assets in the quarter which was outsized related to timing of payments in Q2. The gross book value of fixed assets, including capital inventory, increased \$36 million this quarter.

Finally, deferred revenue at the end of Q3 was \$147 million, down 2% from \$150 million at the end of the second quarter of 2022 and down 3.3% from \$152 million for the third quarter of last year.

That concludes my remarks and I'll now turn it back to Elliot.

Closing Remarks [Elliot Noss, President and Chief Executive Officer]

Thanks, Dave.

I turned 60 last month, and it took until a month before I turned 60 to raise equity for the first time. So now I will make another departure and will talk about valuation on this investor call, something I have not done in any detail since we turned public over twenty years ago.

This feels like the right conversation to have with investors as we are immersed in our 2023 planning and we settle into the role of TCX as capital allocator. I want to share the way we are thinking about that role and to place it in the context of where the world is more generally.

First, let's talk about the three operating businesses at a high level. We are not fans of complex valuation models. A wall of numbers can offer a sort of a placebo, allowing people to be comforted by, and too often fooled by, precision. We prefer being generally right to precisely wrong.

We value our three operating businesses simply. We value Tucows Domains on the basis of cash EBITDA; Wavelo on the basis of last quarter annualized recurring revenue; and Ting on the basis of homes passed and customers loaded. I will now talk in more detail about each.

With Tucows Domains, it has been a solid cash generator since it launched in 2000. It has funded a number of acquisitions in the domains business, and it has funded every other business we launched—from Ting Mobile to Ting Internet to Wavelo. This business has incredibly reliable cash flows and, other than acquisitions, is not easy to grow. Low alpha; very low beta. It is also a mature business that has had to be efficient on a net margin basis in order to successfully compete. Historically, we view our operating efficiency as what allowed us to be the acquirer rather than the acquired. I note we expect this same characteristic to be relevant when the fiber market turns to consolidation. EBITDA multiple is the obvious, easy valuation metric for Tucows Domains.

Wavelo, on the other hand, is essentially a SaaS startup with a couple of strong anchor customers and a strong team in a market space with a lot of room for growth. If we look at the

main driver here as telecom moving to the cloud, the best estimates are that this process is only 20% complete. In this regard, telecom is behind even insurance or banking.

When we think of the most appropriate valuation metric, we view it as a multiple of annual recurring revenue. We view the last quarter, or last month annualized, as the right input. We also view the multiple as being influenced by profitability, strong customers, pipeline, market size and team. Of course, this is not an exhaustive list.

With Ting, during the massive coax-to-fiber build-out taking place in the United States, we believe that the best way to value these businesses is on a multiple of homes passed and/or customers. The multiples here are typically a function of expected take rates, churn and profitability. Once the build-out in the industry is complete, the valuation method will quickly shift to EBITDA multiple. Although I note that as capital allocators, we will prefer a metric that captures network maintenance costs as this is certainly a difference both between fiber networks and particularly between fiber and coax networks.

In each of these three cases, the actual multiples used will vary over time.

We are spending time internally following each of these three areas, but there is no secret sauce here. We are simply tracking public information which is readily available. If an investor or potential investor asks me what multiple to use, I will remind them they also have Google and can look up the current state of play themselves.

I also wish to be clear that I am sharing our thinking as capital allocators. You, the investor, value our stock every day in the market. I felt it important for you to understand how we view things: as the sum of those three parts, plus whatever is happening at a TCX level.

It is also clear that on this basis, by even very conservative multiples, TCX is quite undervalued. We know we are like every parent who thinks highly of their children, but we wanted those listening to know the basis for our belief.

Finally, we are expecting a period of economic uncertainty. I would not call it a recession or expansion. There are factors like interest rates, geopolitical uncertainty, economic inequality and, of course, climate change that will be a drag on the global economy. There are also things happening in the economy, primarily around the continued progress of technology, that are creating significant growth opportunities. When you combine the above with the world entering a period where the impact of demographics will be a headwind for the first time in modern history, you get uncertainty.

In uncertainty, the most important thing to focus on is cash generation. When times are good, cash generation is good but often undervalued. When times are uncertain, cash generation is great! For better or worse, across more than a quarter century, that is what we have done: focus on cash generation. If I had to set up 2023 with one thought, it would be to put our heads down and focus on efficiency and cash generation while feeding responsible growth.

And with that, I look forward to your written questions and exploring areas that interest you in greater detail. Again, please send your questions to ir@tucows.com by Thursday, November 10th, and look for our recorded Q&A audio response and transcript to this call to be posted to the Tucows website on Tuesday, November 22nd at approximately 4 p.m. Eastern time. Thank you.
